

OFFER OF PROOF
HOME TELEPHONE COMPANY

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS INDEPENDENT TELEPHONE
ASSOCIATION)

Petition for initiation of an investigation of)
the necessity of and the establishment of a)
Universal Service Support Fund in accordance)
with §13-301(d) of the Public Utilities Act)

Docket No. 00-0233

Illinois Commerce Commission On Its Own)

Investigation into the necessity of and, if)
appropriate, the establishment of a Universal)
Support Fund pursuant to Section 13-301(d))
of the Public Utilities Act.)

Docket No. 00-0335

REBUTTAL TESTIMONY

OF

GORDON J. KRAUT, JR.

ON BEHALF OF

HOME TELEPHONE COMPANY

OFFICIAL FILE

IL C. C. DOCKET NO. _____

Exhibit No. _____

Witness _____

Date 6/19/01 Reporter _____

June 12, 2001

Offer of Proof

1 Q. Please state your name, occupation and business address.

2 A. My name is Gordon Kraut. I am a consulting manager with GVNW
3 Consulting, Inc. GVNW Consulting, Inc.'s principal business is
4 telecommunications consulting for small independent telephone companies.
5 My business address is 3220 Pleasant Run, Springfield, Illinois 62707.

6 Q. Are you the same Gordon Kraut who filed testimony in this proceeding for
7 numerous small telephone company companies on April 20, 2001?

8 A. Yes I am.

9 Q. What is the purpose of your rebuttal testimony?

10 A. The purpose of my testimony is to present an embedded cost study for Home
11 Telephone Company that represents the cost of supported services. I also present a
12 summary of Home Telephone Company's state switched access costs and the current
13 revenues billed by the company to recover those costs, based on the embedded cost
14 methodology.

15 Q. Do you have any Schedules attached to your rebuttal testimony?

16 A. Yes. Attached to my rebuttal testimony are Exhibit 4.0, Schedules 4.01 and 4.02,
17 which I will explain later in more detail. These schedules were prepared by me or
18 under my direction.

19 Q. Does Home Telephone Company have a cost separations study performed on an
20 annual basis in accordance with FCC Part 36 and Part 69 rules?

21 A. Yes. In addition, cost study estimates are performed at points throughout the year.

1 Q. Has GVNW completed Home Telephone Company's Year 2000 cost separations
2 study?

3 A. ~~No. The 2000 cost study is not yet done. Therefore, for purposes of preparing my~~
4 ~~Exhibit 4.0, Schedules 4.01 and 4.02, we used the latest cost separations study~~
5 ~~estimate for 2000. This estimate was prepared based on the August 31, 2000~~
6 ~~financials for the Company with adjustment for known and measurable adjustments~~
7 ~~provided by the Company. This is the same estimate that Home used as the basis for~~
8 ~~their Interstate Carrier Common Line draw for 2000.~~

9 Q. What is the purpose of preparing the cost separations study and the cost
10 separations study estimates for Home Telephone Company?

11 A. The purpose of preparing the annual cost separations study is to determine the
12 company's costs of operation for the year 2000. These costs are separated
13 jurisdictionally using the Part 36 and Part 69 cost separations procedures as defined
14 by the Federal Communications Commission ("FCC").

15 Q. How is this annual cost separations study used by Home Telephone Company?

16 A. The results from the annual cost separations study for Home Telephone Company are
17 used for three purposes. First, the cost separations study is used to develop interstate
18 access rates, which need to be filed with the FCC in July. Also, pursuant to the
19 Fourth Interim Order of the Illinois Commerce Commission in Docket No. 83-0142,
20 the information is used to develop intrastate access rates, which mirror interstate
21 access rates for the state jurisdiction with limited adjustments. Second, the cost
22 separations study will provide the cost information necessary for the company to

1 finalize Carrier Common Line settlements with the NECA pool for the year 2000.
2 Finally, certain information from the annual cost separations study is used in the
3 calculation of federal universal service support mechanisms.
4

5 **Q. Does the Home Telephone Company Year 2000 cost study estimate provide any**
6 **information which might be useful in this proceeding?**

7 **A.** Yes. Because the cost study estimate generates a jurisdictional separation of costs,
8 and the separation of costs in each jurisdiction into access element categories, it can
9 be used to determine the company's revenue requirements for any of the three major
10 jurisdictions. These jurisdictions are interstate, intrastate and local. The revenue
11 requirement access element breakdowns for the interstate and intrastate jurisdictions
12 are carrier common line, local switching, transport, special access and non-access.

13 **Q. Referring to Exhibit 4.0, Schedule 4.01, what steps were undertaken in the**
14 **preparation of the embedded cost study?**

15
16 **A.** Schedule 4.01 was developed using Home Telephone Company's year 2000 annual
17 cost separations study. The annual cost separation study, for the above referenced
18 purposes, is run using the FCC prescribed method of weighting the Dial Equipment
19 Minutes ("DEM") factor which is three (3) times the interstate factor based on
20 relative subscriber traffic usage. In preparing the schedule for use in this rebuttal
21 testimony, the embedded cost study for Home Telephone Company was completed by
22 running a Part 36/69 cost separations study absent the factor weighting for interstate
23 DEM. Running the cost separations study without the interstate DEM weighting

factors reflects the appropriate separated costs for the local, intrastate and interstate jurisdictions based on the fact that the DEM local switching support has been removed from interstate access rates and placed into an explicit high cost support fund. Using the unweighted DEM factors properly moves the revenue requirement associated with local switching support from the interstate jurisdiction to the local jurisdiction.

Q. What does this Exhibit 4.0, Schedule 4.01 show?

A. This Schedule shows the accumulation of all the appropriate separated cost elements, from the cost study, which comprise the cost of providing local service. In developing the cost of supported services for this analysis, we have included the Part 36 local revenue requirement, the intrastate Part 69 carrier common line revenue requirement and the interstate Part 69 carrier common line revenue requirement. Since the carrier common line revenue requirements from a cost separations study are designed to recover a portion of the local loop costs, it is appropriate to include those costs in this analysis.

In summary, this Schedule shows that Home Telephone Company has embedded costs of providing the supported local services that exceed the revenues received from an affordable local rate and federal universal service support mechanisms.

Q. Please explain the format of Exhibit 4.0, Schedule 4.01 in more detail.

A. Schedule 4.01, is divided into three pages. The first page shows the calculation of the total embedded cost of the supported services and then deducts the appropriate current

1 revenue streams that recover the cost of the supported local services. The product of
2 this calculation is Home Telephone Company's showing of need for State Universal
3 Service Fund support related to the provision of supported local services. The second
4 page of the analysis shows the calculation of costs related to local services that are not
5 supported. The third page of the analysis compares the embedded cost of state
6 switched access to the state switched access revenues received in the year 2000.

7 Schedule 4.01, Page 1, Line 1 of the analysis displays the Interstate Carrier
8 Common Line Revenue Requirement from the interstate Part 69 cost study output.
9 Line 2 of the analysis displays the Intrastate Carrier Common Line Revenue
10 Requirement from the intrastate Part 69 cost study output. Line 3 displays the state
11 local switching access revenue requirement shift to the local jurisdiction based on the
12 state local switching rate adjustment for non-traffic sensitive (line termination) costs.
13 Line 4 displays the local jurisdiction revenue requirement from the Part 36 cost study
14 output. Line 5 displays the amount of the local revenue requirement associated with
15 the provision of ancillary services such as custom calling features and CLASS
16 features. A detailed calculation of this cost is provided on Page 2 of this Schedule.
17 Line 6 displays the total embedded cost of supported services. Line 7 displays the
18 total access line count for the company as entered on Attachment # 5 of IITA Exhibit
19 2, which was associated with Mr. Schoonmaker's March 23, 2001 direct testimony.
20 Line 8 displays the embedded cost per line per month, calculated by dividing Line 6
21 by Line 7, then dividing that result by 12 to arrive at a monthly amount. Line 9
22 displays the affordable rate for local service as entered in IITA Exhibit 2, Attachment

1 #5, as mentioned previously. The affordable local rate figure includes the state
2 subscriber line charge. Line 10 summarizes the total revenue sources for the
3 supported local services. Line 11 summarizes the Federal support revenue sources for
4 the supported services. These include the Federal High Cost Loop Support payments,
5 Federal Local Switching Support payments and the company's interstate carrier
6 common line revenue requirement. Line 12 displays the Illinois Universal Service
7 Fund eligibility amount for the supported services based on this embedded cost
8 analysis.

9 Schedule 4.01, Page 3, Line 1 of the analysis displays the intrastate switched
10 access revenue requirement of the company. This total includes the revenue
11 requirement totals for local switching, information and local transport from the
12 intrastate Part 69 study report output. Line 2 shows the switched revenue requirement
13 reduction associated with the intrastate local switching rate NTS costs shifted to the
14 local jurisdiction (as described in the Page 1, Line 2 definition above). Line 3
15 calculates the net intrastate switched access revenue requirement, which consists of
16 the gross switched revenue requirement less the local switching NTS cost shift. Line
17 4 displays the intrastate switched access revenues for Home Telephone Company for
18 the year 2000. Line 5 displays the difference between the net intrastate switched
19 access revenue requirement and the switched access revenues received by the
20 company.

21
22 **Q. What is Exhibit 4.0, Schedule 4.02?**
23

1 A. Schedule 4.02 is the source data used in preparing Schedule 4.01. The first
2 page is the Part 36 Total Company Revenue Requirement output from the cost
3 separations study. The second page is the Part 69 Interstate Revenue Requirement
4 output from the cost separations study. The third page is the Part 69 Intrastate
5 Revenue Requirement output from the cost separations study.

6 **Q. Does the cost separations study alone provide sufficient detail to show the**
7 **embedded cost of the supported services in the local revenue requirement?**

8 A. No. We need to make some additional modifications to the cost information
9 produced by the separations study to eliminate the costs associated with vertical
10 services. This cost adjustment is incorporated in Line 5, Page 1 of Schedule 4.01.
11 Schedule 4.01, Page 2 details the calculation for the removal of these costs. The
12 result of the calculation on Schedule 4.01, Page 2 ties to the adjustment made to local
13 revenue requirement on Line 5, Page 1 of Schedule 4.01.

14 **Q. You've stated that, "we need to make some additional modifications to the cost**
15 **information produced by the separations study to eliminate the costs associated**
16 **with vertical services." Why is that?**

17 A. The cost separations study separates local costs from interstate and intrastate access,
18 but it does not break out the costs associated with each local service.

19 **Q. What is the problem with that?**

20 A. For purposes of this proceeding, we are calculating the embedded cost for the
21 "supported services" only.

1 Q. Does Home Telephone Company have a separate rate for each of the "supported
2 services"?

3 A. No. Home Telephone Company does not charge separately for each of the "supported
4 services". I would note, however, that Home Telephone Company does have a
5 separate charge for touch tone service.

6 Q. Does Home Telephone Company provide basic local service to its subscribers for
7 a flat rate fee?

8 A. Yes.

9 Q. Does the basic local service which Home Telephone Company offers for a flat fee
10 to its subscribers include all of the supportive services as identified in the FCC
11 rules?

12 A. With the exception of touch tone, which I mentioned previously, the answer is yes.
13 Home Telephone Company's basic local service plus the touch tone charge includes
14 the following elements: Voice grade access to the public switched network, local
15 usage, dual-tone multi-frequency signaling, single party service, access to emergency
16 services, access to operator services, access to interexchange service, access to
17 directory assistance and toll control service for low income customers.

18 Q. Does Home Telephone Company's basic local service, which they provide for a
19 flat fee to their subscribers, include any additional telecommunication services
20 that are not a part of the FCC's list of supportive services?

21 A. No.

1 Q. Does Home Telephone Company offer other telephone services to its subscribers
2 for an additional fee?

3 A. Yes.

4 Q. Please briefly describe the telephone services that Home Telephone Company
5 provides beyond the FCC's list of supported services.

6 A. In addition to basic local service the company provides custom calling features,
7 CLASS features, local operator services and local directory assistance. In addition to
8 the ancillary local services, the company also offers state and interstate access services to
9 interexchange carriers. These services include both switched and special access services.
10 Digital subscriber line ("DSL") service is also offered out of the company's interstate
11 access tariff to end user customers. In conjunction with the offering of DSL service from
12 the interstate access tariff, the investments and other costs related to this service are
13 contained in the company's interstate special access revenue requirement.

14 Q. Does the annual cost separations study performed by GVNW for Home
15 Telephone Company contain sufficient information for you to break out the costs
16 associated with these additional services?

17 A. No it does not.

18 Q. If this is true, then how can the cost separations study help us determine the
19 embedded costs of the "supported services"?

20 A. We have to identify or calculate an estimate for the costs that are properly assigned to
21 the vertical services and incorporate that information into Schedule 4.01, Page 1.
22 This calculation is shown on page 2 of Schedule of 4.01 and the cost is incorporate on

line 5 of page 1 where it is subtracted from the costs of providing local service. After factoring out the costs of vertical services, the results of our embedded economic cost study will be a reasonably accurate depiction of the embedded economic costs of the supported services.

Q. Please explain the calculation of the adjustment on Page 2 of Schedule 4.01, which is reflected on Page 1, Line 5 of Schedule 4.01.

A. The cost for these ancillary services was developed using costs provided by the equipment vendors and company financial data for these services. We then used the relationship of the ancillary service investment to total investment to reduce the costs for these services from the total revenue requirement developed for local services by the cost separations study process

Q. Mr. Kraut, turning back to your Schedule 4.01, what is the revenue deficiency of Home Telephone Company with respect the "supported services" based on this embedded cost study?

A. The result of our analysis shows that Home Telephone Company has a revenue deficiency for supported services of \$474,128.

Q. Does this Schedule reflect any current Illinois High Cost Fund or DEM Weighting Fund Support?

A. No. Since we are developing a cost of service analysis, we are only subtracting the appropriate federal support payments related to the local services per the statutory requirement for the economic cost test. The existing state DEM Weighting and State

1 High Cost Funds are scheduled to expire on September 30, 2001. Therefore, these
2 funding amounts are not represented in the analysis.

3 Q. Does your Schedule 4.01 consider the federal USF support funds, which Home
4 Telephone Company receives on an annual basis, as part of the embedded cost
5 analysis?

6 A. Yes. As previously mentioned, Line 11, Page 1 of the schedule subtracts the
7 appropriate federal support payments related to the local supported services consistent
8 with the manner in which federal support has been treated throughout this proceeding.

9 Q. Mr. Kraut, Line 6, Page 1 of your Schedule 4.01 shows the total embedded costs
10 of the supported services. Does your Schedule 4.01, Page 1, Line 6 Total
11 Embedded Cost exclude the costs properly assigned to intrastate access?

12 A. Yes. The intrastate access costs are excluded from this analysis.

13 Q. Mr. Kraut, Line 6, Page 1 of your Schedule 4.01 shows the total embedded costs
14 of supported services. Does your Schedule 4.01, Page 1, Line 6 Total Embedded
15 Cost exclude the costs properly assigned to interstate access?

16 A. Yes. The interstate switched access costs and revenues are excluded from this
17 analysis. However, the interstate carrier common line costs have been included as
18 part of the local service cost in this analysis, since these costs are related to the local
19 loop portion of the network. Because the statute requires all of our federal support
20 revenues for the local loop to be included as recovery amounts for this analysis, we
21 needed to include the local loop costs assigned to the interstate jurisdiction for

1 recovery in the separations process. Otherwise we would not properly be matching
2 revenues to the associated costs.

3 Q. Mr. Kraut, Line 6, Page 1 of your Schedule 4.01 shows the total embedded costs
4 of supported services. Does your Schedule 4.01, Page 1, Line 6 Total Embedded
5 Cost exclude the costs properly assigned to DSL service?

6 A. Yes. The costs that are associated with DSL service are not included in the costs of
7 "local service" or the costs of the "supported services" in our embedded economic cost
8 study. The costs associated with DSL service are properly assigned to the interstate
9 jurisdiction and in the cost study process flow through to the interstate special access
10 element. Therefore, since these costs are properly assigned to interstate special access
11 and since our embedded economic cost analysis only shows the costs assigned to local
12 exchange services, these costs are not included in the analysis of supported services and
13 do not need to be subtracted out.

14 Q. Mr. Kraut, directing your attention to your Schedule 4.01, page 3, was it
15 prepared to show the revenue surplus or deficiency with respect to the
16 Company's intrastate access services provided to other carriers using the same
17 embedded cost analysis?

18 A. Yes. Schedule 4.01, Page 3 displays the intrastate switched access revenue
19 requirement and the intrastate switched access revenues for Home Telephone
20 Company for the year 2000, and it calculates the difference between the net intrastate
21 switched access revenue requirement and the switched access revenues received by
22 the company.

1 Q. Mr. Kraut, does the embedded cost study contained in your Exhibit 4.0,
2 Schedule 4.01 represent a reasonable statement of the embedded costs of the
3 supported services?

4 A. Yes.

5 Q. Does that conclude your testimony?

6 A. Yes.

Home Telephone Company
Embedded Cost Analysis
Based on Part 36/69 and Historical Data

Docket Nos. 00-0233 & 00-0335 (Consolidated)
Home Telephone Company Exhibit 4.0
Schedule 4.01
Page 1 of 3

IUSF ELIGIBILITY AMOUNT			Total
Line #	Description of Data	Source of Data	Amount
1	Interstate Carrier Common Line Rev. Req.	Interstate Part 69 Study, Page 1, Line 219	\$409,162
2	Intrastate Carrier Common Line Rev. Req.	Intrastate Part 69 Study, Page 1, Line 219	\$0
3	Line Termination Rev. Req. Shift for State SLC	Intrastate LS2 Rate Development	\$24,694
4	Local Rev. Req.	Part 36 Study, Page 1, Line 219	\$1,548,979
5	Cost of Unsupported Local Services	Page 2 of this Exhibit	\$ 9,565
6	Total Embedded Cost	Sum of Lines 1 through 4 less Line 5	<u>\$1,973,270</u>
7	Access Lines	IITA Exhibit #2, Attachment 5	1,012
8	Economic Cost per Line per Month	Line 6 divided by Line 7	\$162.49
9	Affordable Local Rate	IITA Exhibit #2, Attachment 5	\$21.75
10	Total Local Revenues - Supported Services	Line 7 times Line 9 annualized	\$264,163
11	Total Federal Support Funds	IITA Exhibit #2, Attachment 5	<u>\$1,234,978</u>
12	IUSF Eligibility Amount	Line 6 minus Line 10 minus Line 11	<u>\$474,128</u>

COST OF UNSUPPORTED SERVICES

	Description of Data	Source of Data	Total Amount
1	Total CO Investment for Ancillary Services	Vendor and company information	\$ 31,900
2	Total Central Office Investment	ICC Annual Report Page 6, Total CO Switching	\$ 1,100,260
3	Total Accumulated Reserve CO Investment	ICC Annual Report Page 20, Line 5 (j)	\$ 536,122
4	Net Central Office Equipment Investment	Line 2 minus Line 3	\$ 564,138
5	Net Rate Base Percentage of CO Investment	Line 4 divided by Line 2	51.27%
6	Net Rate Base Portion of Ancillary Service Inv.	Line 1 multiplied by Line 5	\$ 16,356
7	Total Study Part 36 Rate Base - Local	Part 36 Cost Study - Page 1, Line 201	\$ 2,722,770
8	Percent of Expense for Local Rev. Req. Adj.	Line 6 divided by Line 7	0.60%
9	Total Local Operating Expenses	Part 36 Cost Study, Page 1, Line 213	\$ 1,089,912
10	Expense Reduction for Ancillary Services	Line 9 multiplied by Line 8	\$ 6,547
11	Return Component Reduction - Local	Line 6 multiplied by 11.25%	\$ 1,840
12	Return Component Reduction w/tax gross up	Line 11 multiplied by 1.64	\$ 3,018
13	Total Local Revenue Requirement Reduction	Line 10 plus Line 12	<u>\$ 9,565</u>

Home Telephone Company
Embedded Cost Analysis
Based on Part 36/69 and Historical Data

Docket Nos. 00-0233 & 00-0335 (Consolidated)
Home Telephone Company Exhibit 4.0
Schedule 4.01
Page 3 of 3

ACCESS SUBSIDY ANALYSIS

	Description of Data	Source of Data	Total Amount
1	Intrastate Switched Access Rev. Req.	Intrastate Part 69 Study, Page 1, Line 219	\$373,992
2	Line Termination Shift for State SLC	Intrastate LS2 Rate Development	\$24,694
3	Net Intrastate Switched Access Rev. Req.	Line 1 minus Line 2	\$349,298
4	Current Intrastate Switched Access Revenues	Year 2000 Trial Balance	<u>\$387,158</u>
5	Subsidy in Access (if negative)	Line 15 minus Line 16	<u>(\$37,860)</u>

CONFIDENTIAL INFORMATION
DO NOT RELEASE WITHOUT AUTHORIZATION

HOME TELEPHONE COMPANY
2000 AVERAGE

PAGE:
06/12/

INTER-STATE

LINE ACCT	CAT	TAXES AND FULL COST DESCRIPTION RATE BASE	TOTAL	COMMON LINE	USF	SWITCH	TRANSMISSION	INFORMATION	LIMITED PAY	SPECIAL ACCLSS	B & C	IX/OTHER
201			1,094,605	628,467	0	116,926	28,762	0	0	120,450	0	0.0000
202		RATE OF RETURN		0.112500	0.112500	0.112500	0.112500	0.112500	0.112500	0.112500	0.112500	0.0000
203		RETURN ON INVESTMENT	123,143	93,203	0	13,154	3,236	0	0	13,550	0	0
205		INCOME ADDS & DEDUCTS	25,778	19,524	0	2,738	678	0	0	2,838	0	0
206		ITC & EXCESS DEF AMORT/AMT	0	0	0	0	0	0	0	0	0	0
207		BALANCE BEFORE FED TAX	97,365	73,679	0	10,416	2,558	0	0	10,712	0	0
208		FEDERAL SURTAX	2,434,800	1,844,135	0	258,573	64,013	0	0	268,079	0	0
209		FEDERAL INCOME TAX	50,158	37,956	0	5,366	1,318	0	0	5,518	0	0
210		BALANCE BEFORE STATE TAX	147,523	111,635	0	15,782	3,876	0	0	16,230	0	0
211		STATE INCOME TAX	11,392	8,620	0	1,219	309	0	0	1,254	0	0
212		RETURN PLUS TAX	184,693	139,779	0	19,739	4,853	0	0	20,322	0	0
213		EXPENSES	653,954	269,383	0	271,286	10,593	856	0	42,628	59,208	0
214		GROSS RECEIPTS TAX	0	0	0	0	0	0	0	0	0	0
215		EXPENSE ADJUSTMENT	0	0	0	0	0	0	0	0	0	0
216		TOTAL EXPENSE	653,954	269,383	0	271,286	10,593	856	0	42,628	59,208	0
217		SUBTOTAL	838,647	409,162	0	291,025	15,446	856	0	62,950	59,208	0
218	7340	AFUDC	0	0	0	0	0	0	0	0	0	0
219		REVENUE REQUIREMENT	838,647	409,162	0	291,025	15,446	856	0	62,950	59,208	0

HOME TELEPHONE CO.
Exhibit 4.0,
Schedule 4.02
Page 2 of 3

CONFIDENTIAL INFORMATION
DO NOT RELEASE WITHOUT AUTHORIZATION

HOME TELEPHONE COMPANY
2000 AVERAGE

PAGE:
06/12

INTRA-STATE

LINE	ACCT	CAT	TAXES AND FULL COST DESCRIPTION RATE BASE	COMMON LINE	USF	SWITCH	TRANSPORT	INFORMATION	LIMITED PAY	SPECIAL ACCESS	B & C	IX/OTHE
201				0	0	202.746	48.143	0	0	40.593	0	0
202			RATE OF RETURN	0.112500	0.112500	0.112500	0.112500	0.112500	0.112500	0.112500	0.112500	0.000
203			RETURN ON INVESTMENT	0	0	22.809	5.416	0	0	4.567	0	0
205			INCOME ADDS & DEDUCTS	0	0	4.578	1.101	0	0	929	0	0
206			11C & EXCESS DEF AMORT/AMT	0	0	0	0	0	0	0	0	0
207			BALANCE BEFORE FED TAX	0	0	18.231	4.315	0	0	3.638	0	0
208			FEDERAL SURTAX	0	0	432.499	104.036	0	0	87.746	0	0
209			FEDERAL INCOME TAX	0	0	9.392	2.223	0	0	1.874	0	0
210			BALANCE BEFORE STATE TAX	0	0	27.623	6.538	0	0	5.512	0	0
211			STATE INCOME TAX	0	0	2.133	505	0	0	426	0	0
212			RETURN PLUS TAX	0	0	34.134	8.144	0	0	6.867	0	0
213			EXPENSES	0	0	313.783	16.327	1.404	0	14.734	89.557	0
214			GROSS RECEIPTS TAX	0	0	0	0	0	0	0	0	0
215			EXPENSE ADJUSTMENT	0	0	0	0	0	0	0	0	0
216			TOTAL EXPENSE	0	0	313.783	16.327	1.404	0	14.734	89.557	0
217			SUBTOTAL	0	0	348.117	24.471	1.404	0	21.601	89.557	0
218	7340		AFUDC	0	0	0	0	0	0	0	0	0
219			REVENUE REQUIREMENT	0	0	348.117	24.471	1.404	0	21.601	89.557	0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS INDEPENDENT TELEPHONE)
ASSOCIATION)

Petition for initiation of an investigation of)
the necessity of and the establishment of a)
Universal Service Support Fund in accordance)
with §13-301(d) of the Public Utilities Act)

Illinois Commerce Commission On Its Own)

Investigation into the necessity of and, if)
appropriate, the establishment of a Universal)
Support Fund pursuant to Section 13-301(d))
of the Public Utilities Act.)

Docket No. 00-0233

Docket No. 00-0335

REBUTTAL TESTIMONY

OF

MICHAEL P. PETROUSKE

ON BEHALF OF

HOME TELEPHONE COMPANY

June 12, 2001

OFFICIAL FILE

IL C. C. DOCKET NO. _____

_____ Exhibit No. _____

Witness _____

Date 6/19/01 Reporter _____

Offer of Proof

1 Q. Please state your name and business address.

2 A. My name is Michael P. Petrouske. My business address is 850 Pluto Street, Geneseo,
3 Illinois 61254.

4 Q. By whom are you employed and in what capacity.

5 A. I am a Vice President of Gridley Consulting Services, Inc. For purposes of this
6 testimony, Gridley Consulting Services, Inc. has been hired by Home Telephone
7 Company.

8 Q. Are you the same Michael P. Petrouske who filed testimony in this proceeding for
9 Leaf River Telephone Company, Home Telephone Company and Tonica Telephone
10 Company on April 20, 2001?

11 A. Yes I am.

12 Q. What is the purpose of your rebuttal testimony?

13 A. The purpose of my testimony is to providing policy recommendations based on an
14 embedded economic cost study for Home Telephone Company that represents the
15 cost of supported services. I also address the issue of implicit subsidies in access.

16 Q. Please summarize your rebuttal testimony.

17 A. Based on the embedded economic cost study, Home Telephone Company proves a
18 need for funding, and meets the statutory requirement of showing that its economic
19 costs exceed its affordable rate plus recovery from other Federal Universal Service
20 Funding Programs. Since Home Telephone Company has met the statutory
21 requirement based on this embedded cost analysis, the company should receive state
22 Universal Service Funding based on either its company-specific Rate of Return
23 showing or the company's embedded economic cost study. The company's state

1 universal service support should not be phased down to the Staff's or AT&T's
2 proposed HAI level of support. Home Telephone Company is also providing
3 information in this testimony that compares its state switched access revenues to the
4 embedded economic cost for state switched access. This comparison is provided to
5 meet the statutory requirement for identifying subsidies in state switched access.

6 Q. Mr. Petrouske, what do you recommend as the appropriate method for
7 determining economic cost for Home Telephone Company in this case?

8 A. Historical embedded costs are the appropriate method for determining the economic
9 costs of the supported services for Home Telephone Company in this docket. In an
10 order in FCC Docket 96-45 adopted May 10, 2001, the FCC has rejected the use of
11 forward-looking cost models for determining universal service requirements for rural
12 carriers. Specifically, the FCC said in paragraph 177 of that Order that "Because the
13 Commission has not developed rural inputs and it is not possible to determine
14 forward-looking costs for rural carriers at this time, we find that rural carriers should
15 continue to receive support based upon their embedded costs while the five-year plan
16 adopted in this Order is in place." (emphasis added).¹ The Commission should follow
17 the FCC's lead and use historical embedded costs rather than forward-looking costs as
18 the basis for cost determination and universal service funding.

¹ While the specific cost model analyzed in the Rural Task Force Recommendations, which the FCC was relying upon, was the FCC's Synthesis Model, rather than the HAI model which has been presented in this docket, the FCC's finding that forward looking costs cannot be determined at this time due the lack of appropriate inputs for rural carriers is equally applicable with respect to the HAI model. AT&T witness Clark, in his Direct Testimony in this docket, recognizes that the inputs for the HAI model are substantially similar to the inputs in the FCC's Synthesis Model when he states on pages 10 and 11 from his Direct Testimony "the default expense figures in the HAI 5.0a model are supported by forward-looking evidence, and their validity has generally been affirmed by the collection of expense factors that has been adopted by the FCC for its Synthesis model. The FCC developed these

1 Q. Has Home Telephone Company had an embedded cost analysis prepared for use
2 in this case to show embedded costs of the supported services based on their year
3 2000 cost separations study?

4 A. Yes. Mr. Gordon Kraut of GVNW has prepared such an embedded cost analysis and
5 has presented it with his rebuttal testimony in Home Telephone Company Exhibit 4.0,
6 Schedules 4.01 and 4.02.

7 Q. Have you reviewed Home Telephone Company's embedded cost study?

8 A. Yes. I have reviewed the results generated by this embedded cost study. I am
9 familiar with the format Mr. Kraut used to provide this embedded cost study, as he
10 and I worked cooperatively with others from our respective firms to develop this
11 format for use in this proceeding. I have prepared and sponsored similar studies for
12 other small telephone companies in this proceeding.

13 Q. Does Mr. Kraut's embedded cost study contained in Exhibit 4.0, Schedule 4.01
14 appear to represent a reasonable statement of the embedded costs of the
15 supported services for Home Telephone Company?

16 A. Yes. This study appears to be a reasonable representation of Home Telephone
17 Company's embedded costs of supported services. Schedule 4.01 was developed
18 using Home Telephone Company's year 2000 annual cost separations study run
19 without the weighted interstate DEM factors. Using the unweighted DEM factors in
20 the cost study run, the study results properly reflect the revenue requirement
21 associated with local switching support as a cost assigned to the local jurisdiction.

expense factors using its own statistical regression analysis, and these factors yield expense levels that match very

1 This is an appropriate approach for purposes of generating the true local service costs
2 for the company. The economic cost study also eliminates the costs associated with
3 non-supported ancillary services. With this adjustment for ancillary service
4 investment and related expenses, the embedded cost study reasonably represents the
5 economic cost of the supported local services.

6 Q. What does this Schedule 4.01 show with respect to the economic costs of
7 supported services for Home Telephone Company?

8 A. Schedule 4.01, Page 1, shows that Home Telephone Company has economic costs of
9 providing the supported local services that exceed the revenues received from its
10 affordable local rate and federal universal service support mechanisms. This
11 Schedule proves that Home Telephone Company satisfies the economic cost test
12 contained in the statute and therefore qualifies for support from the state universal
13 fund.

14 Q. Turning back to Home Telephone Company's Schedule 4.01 and focusing on the
15 IUSF Eligibility amount, can you determine what Home Telephone Company's
16 IUSF support need for supported services will be based on its Year 2000
17 embedded economic cost study?

18 A. Yes. The results of this embedded economic analysis show that Home Telephone
19 Company has a revenue deficiency that would generate an Illinois Universal Service
20 Funding eligibility for supported services in the amount of \$474,128.

1 Q. How does the result from the embedded economic cost study compare to the
2 Rate of Return analysis filed by Home Telephone Company in this proceeding on
3 April 20, 2001?

4 A. The Rate of Return analysis filed by the company demonstrated a deficiency of
5 \$633,541 in order to meet the IITA/Staff's proposed rate of return of 11.21%.

6 Q. What is your recommendation to the Illinois Commerce Commission with
7 respect to the "economic cost" element of this proceeding, and the appropriate
8 level of universal service support funding for the Home Telephone Company?

9 A. Since Home Telephone Company has met the statutory requirement based on this
10 embedded economic cost analysis, the company should receive state Universal
11 Service Funding based either the company-specific Rate of Return showing or its
12 embedded economic cost study, and, not be phased down to the Staff's or AT&T's
13 proposed HAI level of support. I understand that the company's counsel intends to
14 argue in this case that my recommendation could be accomplished through a finding
15 that the embedded cost analysis is the "economic cost" of the supported services
16 contemplated by the statute, or a finding that either the Rate of Return analysis or the
17 embedded economic cost analysis can be used as a reasonable proxy for determining
18 the company's need for universal service funding.

19 Q. Mr. Petrouske, in your opinion does the Rate of Return analysis and/or the
20 embedded economic cost analysis represent a more reasonable representation of
21 the company's need for universal service support than the HAI model?

22 A. Most certainly.

1 Q. Do you have any specific reasons why the HAI analysis should not be used to
2 determine the universal service funding for Home Telephone Company?

3 A. Yes. Despite the suggestions to the contrary by Staff witness Mr. Koch in his direct
4 testimony, the HAI model or any other forward-looking cost model will overestimate
5 the costs of some companies and underestimate the costs for others. AT&T witness
6 Mr. Clarke specifically recognizes this point at lines 23-25 on page 4 of his direct
7 testimony. This conclusion is also consistent with my understanding of the findings
8 of the FCC's Rural Task Force in their Recommendations to the Federal State Joint
9 Board on Universal Service adopted on September 22, 2000 in CC Docket No. 96-45.
10 (pp. 17-18)

11 In addition, the evidence of the various parties in this proceeding that have addressed
12 the HAI issue shows that the results on an individual company basis vary widely
13 based on making a small number of input changes in the default values. In adjusting
14 the input values to more closely reflect actual company circumstances, the results
15 from the model can be extremely different from the results produced with the default
16 values. The ICC Staff's HAI proposal for Home Telephone Company relies heavily
17 on the default values resident in the model and accepts proposed adjustments by
18 AT&T witness Mr. Clarke which he states more accurately reflect the defaults in
19 more current versions of the model while rejecting the majority of the proposed input
20 and default adjustments made by Mr. Schoonmaker and myself. AT&T witness Mr.
21 Clarke, in his direct testimony, relies heavily on the FCC's inputs for its Synthesis
22 Model and how closely those inputs compare to the HAI default inputs. ICC Staff

1 witness Mr. Koch accepts the justifications by Mr. Clarke as reasonable in accepting
2 most of his input adjustments for the Staff revised HAI model runs.

3 The difficulty for this Commission in considering the use of the HAI model for Home
4 Telephone Company, when there is a reasonable embedded economic cost analysis in
5 the record, is that the FCC has recently stated that the inputs in the existing forward-
6 looking cost models are not appropriate for modeling the costs of the rural carriers at
7 this time. The FCC went so far as to say "it is not possible to determine forward-
8 looking costs for rural carriers at this time." Because the results from forward-looking
9 cost models do not work for small rural carriers, the FCC has adopted the use of
10 embedded costs for the rural carriers to be used for the purpose of determining
11 universal service support for the next five years. Since the justification by both
12 AT&T and the ICC Staff for their proposed inputs to the HAI model are reliant on the
13 FCC's adoption of the Synthesis Model for non-rural carriers, the recent FCC
14 decision with respect to the rural carriers essentially renders their HAI model results
15 meaningless and unreliable.

16
17 **Q. Have you done an investigation of Home Telephone Company's intrastate**
18 **switched access costs and revenues to determine whether or not there are any**
19 **implicit subsidies?**

20 **A. Yes. Schedule 4.01, Page 3 displays the intrastate switched access revenue**
21 **requirement and the intrastate switched access revenues for Home Telephone**
22 **Company for the year 2000. The schedule displays the difference between the net**

1 intrastate switched access revenue requirement and the switched access revenues
2 received by the company. In the 2000 embedded cost study, Home's intrastate
3 switched access revenues are \$37,860 over its embedded costs, as shown on Line 5 of
4 this Schedule. These revenues are the result of usage sensitive intrastate switched
5 access rates that mirror Home Telephone Company's federal switched access rates.
6 The rates are set in this mirrored fashion based upon the policy decision of the Illinois
7 Commerce Commission in the 4th Interim Order in ICC Docket No. 83-0142.

8 **Q. What do you recommend the Commission do about Home Telephone Company's**
9 **intrastate switched access revenue surplus?**

10 **A.** Nothing at this time. Contrary to AT&T's position, the statute does not disqualify a
11 LEC from Universal Service Funding simply because its current intrastate access
12 revenues exceed intrastate access costs. This issue should be addressed in detail in
13 the next phase of this proceeding. The FCC is currently reviewing access changes and
14 evaluating various proposals regarding access charge reform. I recommend that the
15 Commission make no changes in access rates in this docket.

16 **Q. Would it serve the policy of the Universal Service Funding provision to adopt a**
17 **pass-fail test for intrastate access subsidies as proposed by AT&T?**

18 **A.** Absolutely not. Under AT&T's proposal, as I understand it, a carrier can have \$1.00
19 in intrastate access subsidy and lose several hundred thousand dollars in needed
20 support. It would completely defeat the purpose of Universal Service and run
21 contrary to the Commission's policy in Fourth Interim Order of 83-0142 in which
22 carriers were supposed to mirror interstate access rates in the intrastate jurisdiction.

1 As I understand the statute as a non-lawyer, there is nothing in the Act that can be
2 interpreted to deny funding to a carrier who otherwise demonstrates a need.

3 Q. Does this conclude your testimony?

4 A. Yes.

5